

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:ITA:B07

PLR-135513-06

Date:

January 08, 2007

LEGEND

Fund =

V =

W =

IC =

X =

Y =

Z =

State P =

Date a =

Date b =

Date c =

Date d =

Date e =

Date f =

Dear :

This responds to your letter requesting certain rulings concerning the application of section 468B of the Internal Revenue Code to Fund. In particular, you requested the following rulings:

1. X may apply § 1.468B-9 of the Proposed Income Tax Regulations, published in the Federal Register on February 2, 1999 (64 F.R. 4801) regarding the method of taxation for income earned by the Fund, transfers to the Fund, and distributions made by the Fund.
2. The Fund is a “disputed ownership fund” under Prop. Reg. § 1.468B-9(a).
3. X is the “administrator” of the Fund as defined under Prop. Reg. § 1.468B-9(b)(1).
4. Pursuant to Prop. Reg. § 1.468B-9(c)(1), the Fund is treated as a C corporation for purposes of subtitle F of the Internal Revenue Code and, except as otherwise provided in Prop. Reg. § 1.468B-9, the Fund is taxable as if it were a qualified settlement fund.
5. Pursuant to Prop. Reg. § 1.468B-9(d), the Fund’s initial basis in the stock portion of the Demutualization Proceeds (as defined below) is equal to the fair market value of the stock portion on the date IC transferred the Demutualization Proceeds to the Fund, Date e, and the Fund’s initial basis in the cash portion of the Demutualization Proceeds is the value of the cash portion on the date IC transferred the Demutualization Proceeds to the Fund, Date e.

FACTS

The information submitted states that V created a trust to operate as a retirement plan. W was named as trustee of the trust. In Date a, the trust purchased annuity contracts (Annuities) from IC to fund the benefit liabilities of the retirement plan’s participants (Plan Participants). W was later declared insolvent by the Federal Deposit Insurance Corporation (FDIC) and W’s trust business was ultimately acquired by X.

V subsequently entered involuntary bankruptcy proceedings, later converted to a voluntary Chapter 11 case. As a result of V’s bankruptcy proceedings, and after a series of transactions and litigation, two new entities, Y and Z, were formed.

In Date b, IC reorganized its business from a mutual insurance company to a stock insurance company in a process commonly referred to as “demutualization.” As a result of the demutualization, the owner of the Annuities became entitled to IC stock.

On Date c, IC filed a petition in interpleader in a District Court of State P (Court) alleging that it was uncertain which party was entitled to the IC Stock and any accrued and unpaid dividends (collectively, the Demutualization Proceeds). IC at no time asserted any interest in, or ownership claim of, the Demutualization Proceeds.

On Date d, X, Y, and Z filed an emergency motion for immediate release of the Demutualization Proceeds. On Date e, the Court granted the parties' motion, ordered IC to re-register the Demutualization Proceeds in the name of X, and ordered X to immediately liquidate the IC stock. The Court further ordered that the proceeds from the sale of the IC stock, and any accrued but unpaid dividends remain subject to the continuing jurisdiction of the Court pending final resolution of all disputes and conflicting claims concerning its ultimate ownership and that X not pay or distribute the Fund to, or on behalf of, a claimant or a transferor without the approval of the Court. On Date f, X sold the IC Stock.

Shortly after the Demutualization Proceeds were received, X filed a pleading with the Court requesting the Court to determine whether the Fund should be distributed to Y, Z, or the Plan Participants. The Court subsequently ruled in favor of Y and against Z and the Plan Participants. The Court's ruling has been appealed and X represents that the matter is expected to remain contested indefinitely.

LAW AND ANALYSIS

Section 468B(g) of the Internal Revenue Code provides, in part, that nothing in any provision of law shall be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax and authorizes the issuance of regulations providing for the taxation of any such account or fund whether as a grantor trust or otherwise. Final regulations under § 468B(g) concerning the taxation of qualified settlement funds (QSFs) were promulgated on December 23, 1992. T.D. 8459, 1993-1 C.B. 68. Although these regulations did not address the taxation of other types of escrow accounts, trusts, or funds, the preamble to the regulations stated that future regulations would address the income tax treatment of accounts, trusts, or funds other than QSFs.

Proposed regulations were issued on February 1, 1999, regarding the income tax treatment of accounts, trusts, or funds other than QSFs. REG-209619-03, 1999-1 C.B. 689. The proposed regulations provide rules for taxing income earned by various escrow accounts and funds, including disputed ownership funds established under the jurisdiction of a court to hold money or property subject to disputed claims of ownership. After receipt of written comments and a public hearing, final regulations concerning disputed ownership funds were adopted on February 3, 2006. T.D. 9249, 2006-10 I.R.B. 546. These final regulations apply to disputed ownership funds established after February 3, 2006. Section 1.468B-9(j)(1).

Applicability of the Proposed Regulations

The initial requested ruling relates to whether the proposed § 468B regulations apply to the Fund. The taxpayer requests a ruling that it may apply Prop. Reg. § 1.468B-9. In this case, the Fund was established on Date e, a date before February 4, 2006, when

the Demutualization Proceeds were re-registered in the name of X pursuant to the Court's order. Section 1.468B-1(j)(2) provides that for disputed ownership funds established after August 16, 1986, but on or before February 3, 2006, the Internal Revenue Service (Service) will not challenge a reasonable, consistently applied method of taxation for income earned by a fund, transfers to a fund, and distributions made by a fund. See also Prop. Reg. § 1.468B-9(h)(2).

Based on the facts presented, the use of the Proposed Regulations is a reasonable method of taxation for the Fund. Therefore, the Service will not challenge the use of Prop. Reg. § 1.468B-9 by the Fund provided the regulation is consistently applied.

Status as Disputed Ownership Fund

The second requested ruling under consideration is whether the Fund is a disputed ownership fund within the meaning of Prop. Reg. § 1.468B-9(a). Prop. Reg. § 1.468B-9(a) provides that an escrow account, trust, or fund that is not a qualified settlement fund is a disputed ownership fund if:

- (1) it is established to hold money or property subject to conflicting claims of ownership;
- (2) the escrow account, trust, or fund is subject to the continuing jurisdiction of a court; and
- (3) money or property cannot be paid or distributed from the escrow account, trust, or fund to, or on behalf of, a claimant or a transferor without the approval of the court.

Based on the facts presented, the requirements of Prop. Reg. § 1.468B-9(a) are satisfied. First, the Fund is not a qualified settlement fund under § 1.468B-1 as it was not established to resolve a claim described in § 1.468B-1(c)(2). Second, the Fund was established to hold money or property subject to the conflicting claims of ownership of Y, Z, and the Plan Participants. See Prop. Reg. § 1.468B-9(a)(1). The Fund is also subject to the continuing jurisdiction of the Court. See Prop. Reg. § 1.468B-9(a)(2). Finally, the Fund requires the approval of the Court to pay or distribute money or property to, or on behalf of, a claimant or a transferor. See Prop. Reg. § 1.468B-9(a)(3). Therefore, the Service will not challenge the Fund's classification as a disputed ownership fund for federal income tax purposes.

Status as Administrator

The third requested ruling addresses whether X is the administrator of the Fund under Prop. Reg. § 1.468B-9(b)(1). Prop. Reg. § 1.468B-1(b)(1) provides that "administrator" means the person designated as such by the court having jurisdiction over a disputed

ownership fund. If no person is designated, the administrator is the escrow agent, escrow holder, trustee, receiver, or other person responsible for administering the fund.

Pursuant to the Court's Order dated Date e, X was designated as the person responsible for administering the Fund. Therefore, based on the facts presented, the Service will not challenge the classification of X as the "administrator" of the Fund. See Prop. Reg. § 1.468B-9(b)(1).

Treatment for Federal Income Tax Purposes

The fourth requested ruling focuses on the treatment of the Fund for federal income tax purposes. Prop. Reg. § 1.468B-9(c)(1) provides that a disputed ownership fund is treated as a C corporation for purposes of subtitle F of the Internal Revenue Code. Further, Prop. Reg. § 1.468B-9(c)(1)(i) provides that, except as otherwise provided in § 1.468B-9, a disputed ownership fund is taxable as a qualified settlement fund if all the assets transferred to the fund by or on behalf of transferors are passive investment assets, for example, cash or cash equivalents, stock, and debt obligations.

As noted above, the Service will not challenge the classification of the Fund as a disputed ownership fund. Therefore, the Service will not challenge the Fund's classification as a C corporation for purposes of subtitle F of the Internal Revenue Code. See Prop. Reg. § 1.468B-9(c)(1). In addition, the Demutualization Proceeds transferred to the Fund include the IC Stock and any accrued but unpaid dividends. The IC Stock and any accompanying rights to accrued but unpaid dividends are passive investment assets within the meaning of Prop. Reg. § 1.468B-9(c)(1)(i). Therefore, based on the facts presented, except as otherwise provided in § 1.468B-9, the Service will not challenge the taxation of the Fund as if the Fund were a qualified settlement fund.

Basis in Transferred Property

The final requested ruling addresses the basis of the Demutualization Proceeds. Prop. Reg. § 1.468B-9(d) provides that, in general, the initial basis of property transferred by, or on behalf of, a transferor to a disputed ownership fund is the fair market value of the property on the date of transfer to the fund.

Based on the facts presented, the Service will not challenge the calculation of the Fund's initial basis in the stock portion of the Demutualization Proceeds as equal to the fair market value of the stock portion on the date IC transferred the Demutualization Proceeds to the Fund, Date e. Further, the Service will not challenge the calculation of the Fund's initial basis in the cash portion of the Demutualization Proceeds as the value of the cash portion on the date IC transferred the Demutualization Proceeds to the Fund, Date e.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

John P. Moriarty
Senior Technician Reviewer, Branch 7
(Income Tax & Accounting)